CENTER ON BUDGET AND POLICY PRIORITIES
820 First Street, NE, Suite 510, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-1056 center@cbpp.org http://www.cbpp.org

September 26, 2001

A PERMANENT CORPORATE TAX RATE CUT: THE WRONG MEDICINE FOR SHORT-TERM ECONOMIC ILLS

by Joel Friedman and Iris Lav

Some policymakers and economists are suggesting a large permanent reduction in the corporate income tax rate — such as cutting the current top corporate rate from 35 percent to 25 percent — as a way to boost the economy in the short term. Using a *permanent* tax reduction to provide a near-term stimulus, however, is a flawed approach and potentially counterproductive. Any short-run problems with the economy should be addressed through *temporary* policies that do not impair the country's long-term fiscal health.

Cutting the top corporate income tax rate from 35 percent to 25 percent would be extremely expensive, possibly costing $900 billion over ten years when the associated debt service costs are included. This large cost would significantly worsen the long-term budget outlook, which has already deteriorated as a result of a weaker economy, the tax cut enacted this spring, and the likelihood of substantially increased expenditures for defense, intelligence, counter-terrorism, and aviation security.

In a meeting with the Senate Finance Committee on September 25, both Federal Reserve Chairman Alan Greenspan and former Treasury Secretary Robert Rubin reportedly advised against cutting the corporate income tax as a way to stimulate the economy.[1] This advice is consistent with the general point both men have stressed in their recent remarks to Congress: avoid fiscal policies that will worsen the long-term budget outlook, because such policies have the potential to exert further upward pressure on long-term interest rates. Unlike short-term interest rates, which have fallen substantially since the start of the year in reaction to steps taken by the Federal Reserve, long-term interest remain largely unchanged. Greenspan and Rubin have noted that long-term rates have remained high because of investors' concerns over whether the U.S. Government, faced with the tax cut and other claims on the budget, will still be able to pay down as much debt as earlier anticipated. High long-term interest rates can dampen economic activity today, discouraging business and housing investment. Higher long-term rates prevent the Fed's rate-reduction policy from being as successful as it otherwise would be in stimulating the economy and worsen prospects for the economy over the long run.

Further long-term revenue losses, such as those associated with a permanent corporate income tax rate cut, would only exacerbate the problems with long-term interest rates. Moreover, higher long-term interest rates would cancel out most or all of the specific short-term stimulus effects that advocates of a corporate rate cut claim such a tax cut would have.

---

[1] Richard W. Stevenson, "Congress Gets Plan to Drop Tax Benefits for Investors and Widen Economic Relief," The New York Times, September 26, 2001.

- Proponents argue that a permanent cut in the corporate income tax rate will improve the long-term earnings outlook for corporations, which in turn would cause an immediate, large increase in stock prices. They maintain that this bounce in the stock market would make investors feel more wealthy, and thus willing to spend more on goods and services — giving a quick shot in the arm to the economy.

- By some estimates, reducing the top corporate rate from 35 percent to 25 percent could yield about $60 billion of extra consumer spending (although these estimates are very questionable, as explained below). Even if this occurred, such a reduction in the top corporate rate would constitute a highly inefficient stimulus policy. Reducing the top corporate income tax rate to 25 percent would require the federal government to incur a large permanent revenue loss — on the order of $900 billion over the next ten years — to achieve the short-term goal of boosting consumer spending by $60 billion this year. In other words, in the best case claimed by the proponents, less than seven percent of the cost of the tax cut would translate into a stimulus from enhanced consumer spending. If it is determined a short-term economic stimulus of this magnitude is needed, it could be achieved far more efficiently by a one-time infusion of funds directly to individuals and businesses through temporary tax cuts or temporary spending increases.

- Moreover, the sharp increase in stock prices that some supporters of the corporate rate cut predict is unlikely to result from a corporate rate reduction. Proponents claim a corporate rate cut would cause more investors to move into stocks and thereby bid up stock prices and trigger a large rise in the stock market, but this argument fails to take into account the countervailing effect on stock prices of the higher long-term interest rates that would result from the large loss of federal revenue. Based on data from the Council on Economic Advisers on the relationship between public saving (i.e., government surpluses) and interest rates, the additional borrowing that the federal government would have to undertake to pay for the corporate rate cut would likely push up long-term interest rates by an amount that would almost completely offset the positive effects the tax cut otherwise would have on stock prices. The higher interest rates would make bonds more attractive and consequently make investors less likely to purchase stocks relative to holding bonds. As a result, investors would be unlikely to move massively into stocks and stock prices consequently would be unlikely to change much.

- Another argument advanced for the corporate rate cut is that corporations might take the extra after-tax earnings they would secure as a result of the tax cut and use them to make additional investments, which would spur the economy. But a corporate income tax cut is not well targeted and would not necessarily induce

such investments. A corporate tax cut rewards investments already made in the past equally with new investments. Furthermore, the evidence suggests that most companies are not strapped for cash with which to make investments. The financial assets held by corporations increased rapidly over the past few years and totaled more than $8 trillion as of the end of June 2001. That companies have not committed more of these funds to new investments apparently reflects their view that new investments are not necessary to meet consumer demand for their products. Adding more money to corporate reserves through a tax cut does little to change this dynamic.

- In addition, only some corporations would benefit from the rate cut; in the short term, a majority would receive no benefit. That is because a corporate tax rate cut benefits only businesses that are profitable and owe corporate income tax. Corporations that fail to generate a profit this year would owe no tax and thus receive no benefit from the rate cut, yet these are the firms more likely to be in need of assistance during the economic slowdown. This proposal would tend to help large, profitable corporations. Small businesses would not benefit from this tax cut, because small businesses are typically organized in way that their income flows through to the owners and is taxed along with the owners' other earnings through the individual income tax rather than through the corporate income tax.

- Finally, some have made the argument that the benefits of a corporate rate cut would be passed along to consumers in the form of lower prices for goods and services. It should be noted that this argument is incompatible with the notion that the tax cut will increase stock prices. To the extent that a tax cut resulted in lower consumer prices rather than higher corporate profits, the tax cut would not increase the willingness of investors to buy stock and the predicted stock market boom would not occur. A corporate tax cut is unlikely to lower consumer prices, however. Most economists believe that the benefits of changes in corporate taxes flow to the owners of stocks, bonds, and other capital and not to workers or consumers, a conclusion reflected in papers issued by both the Congressional Budget Office and the Treasury Department. Even if some portion of the benefit did flow to consumers, $900 billion would be a very high price to pay for what could only be a few billion dollars in short-term stimulus.

There may well be a need for the government to provide a short-term economic stimulus to the U.S. economy. In devising any immediate stimulus, however, policymakers should be mindful of the possibility of doing harm to the economy by worsening the long-term federal budget outlook and thus driving up long-term interest rates. This is a point that Chairman Greenspan emphasized before the Senate Banking Committee in a hearing on September 20 and repeated in a meeting with Members of the Senate Finance Committee on September 25. The *New York Times* reported Chairman Greenspan as saying at the Banking Committee hearing that one risk to the economy's long-run prospects would be if long-term interest rates shot up in

response to concern among bond market investors that the government would not be able to pay down the national debt.

To avoid such harm, four principles for an appropriate stimulus should be kept in mind. A stimulus should be: a) made available to individuals and businesses quickly to spur spending in the very near future; b) enacted for a short, fixed period of time and not continued after the economy recovers; c) closely related to the immediate problems the economy is experiencing; and d) sound policy in its own right. (See box on page 5 for further discussion.) A permanent cut in the corporate tax rate fails on all of these counts.

Would a Permanent Cut in Corporate Tax Rates Result in a Significant Rise In The Stock Market?

Proponents of the proposal to reduce the corporate income tax rate claim that a permanent reduction in these rates would provide stimulus to the economy through an increase in both consumer spending and business investment. A corporate rate cut, however, would be an ineffective mechanism to boost business investment (as discussed in the next section), while the likelihood of consumer spending increasing substantially as a result of a rate cut seems even more remote. Unlike the current "rebate" checks, which place money directly into the hands of consumers for them to spend, a corporate rate cut is said to increase consumer spending through a somewhat more circuitous path — through a rise in the stock market.

Supporters of the proposal argue that a permanent corporate rate cut will improve the earnings outlook for companies that pay corporate taxes. In theory, stock prices reflect the anticipated future earnings of companies, so a company's stock price would rise if its projected after-tax earnings increased as a result of having to pay lower corporate taxes. Owners of the stock would feel wealthier when the price rises. Many economists believe that investors, even without selling their stock, spend more when stock prices rise simply by virtue of feeling wealthier. It is this "wealth effect" of higher stock prices — the additional spending that occurs when investors feel wealthier after their stock portfolios have increased in value — that some supporters of a corporate rate cut are relying on to provide immediate stimulus to the economy.

But this optimistic scenario is unlikely to occur for one key reason — it ignores the impact on long-term interest rates of the huge cost associated with a large reduction in the corporate tax rate. In 1998, the last year for which IRS data are available, companies subject to the corporate income tax had taxable income of $663 billion and paid $182 billion in corporate income taxes. The Congressional Budget Office estimates that corporate income taxes will grow to more than $300 billion by 2011 and that, over the decade, corporate income tax revenues will total about $2.6 trillion. Dropping the top corporate income tax rate from 35 percent to 25 percent — a 28.6 percent reduction in the rate — could result in revenue losses of roughly $700

Principles for Short-term Economic Stimulus

A policy designed to address a short-term problem will necessarily have different characteristics from a policy intended to meet long-term needs. Using fiscal policy — tax cuts and spending increases — to address a short-term economic slowdown is particularly tricky, because the timing of the policy is so crucial. To be useful, stimulus must spur the economy either before or during the slowdown. If the policy takes effect after the economy has recovered, it could actually be harmful, possibly overstimulating the economy and fueling inflation. Following are four principles for developing an economic-stimulus package:

- ***Quick impact*** — Economic stimulus requires quickly getting money into the hands of consumers and businesses who in turn will spend it (rather than save it). It is therefore generally preferable to use existing programs or channels to disburse funds. Developing new administrative structures or allocation formulas frequently requires too much time. Similarly, programs should be "quick spending." In the past, well-intentioned infrastructure or job creation programs often have failed to provide timely assistance because of the long lead-times needed before funds could be spent.

- ***Temporary programs*** — Given the temporary nature of the economic slowdown, any programs designed to address the problem should be temporary. Spending increases and tax cuts should be time-limited and should terminate as the economy recovers. As discussed above, there are concerns about having stimulus come too late; a permanent policy would pose similar problems — providing stimulus after the slowdown has ended and possibly overheating the economy during the recovery period. Moreover, the long-term cost of a permanent policy change would be much greater than instituting the same policy on a temporary basis. These long-term costs would be an unnecessary burden on the budget and could have negative economic consequences, such as higher long-term interest rates (see box on page 8 on interest rates).

- ***No "hitchhikers"*** — Addressing a short-term economic slowdown poses unique policy challenges and requires a fine-tuned response. Thus, certain policy options that might otherwise make good public policy could be inappropriate as economic stimulus. Policymakers should avoid the temptation of pushing their favorite policies as a way to provide stimulus if these policies are not well targeted on meeting the economy's short-term needs. Stated another way, there should be no "hitchhikers" on the legislative vehicle used to provide economic stimulus; a stimulus package should not become a freight train for other items.

- ***Good policy*** — Finally, it is always worth repeating that public funds are spent to achieve a specific policy outcome, and that funds should be spent as effectively and efficiently as possible. This public policy principle applies equally to any economic stimulus. Although the urgency surrounding an economic stimulus package cannot be ignored, it still should not be interpreted as a license to waste scarce public resources.

billion over ten years.[2] These lower revenues would mean that projected surpluses would be smaller, national saving would consequently be lower, and the national debt would not be reduced as quickly, resulting in higher debt service costs for the government. When these interest costs are added to the revenue losses, the total reduction in the surplus could amount to about $900 billion over the next ten years. (If the corporate income tax rate were reduced from 35 percent to 30 percent, as reportedly suggested by the National Association of Manufacturers, these estimates would essentially be halved. A quite substantial cost — about $450 billion over ten years — would still be incurred.)

For the stock market boom predicted by the supporters of a corporate income tax rate cut to occur, investors must be willing to pay more for stocks — that is, they must find stocks more attractive than other investments such as bonds. Supporters of the proposal maintain that investors will pay more for stocks once the tax cut boosts after-tax corporate earnings. But the corporate rate cut, by significantly slowing the pace of the federal government's debt reduction, also would result in higher long-term interest rates (see box on page 8). These higher interest rates effectively increase the rate of return on bonds. The key issue is whether increased bond yields would attract significant amounts of funds that otherwise would have gone toward bidding up the price of stocks.

This would appear to be the case. Consistent with estimates from the Council on Economic Advisers and Harvard economist Martin Feldstein on the impact of additional federal borrowing on long-term interest rates, Brookings Institution senior fellows William Gale and Peter Orszag and Brookings visiting fellow Gene Sperling have found that the cost of the proposed corporate rate cut would increase federal borrowing sufficiently to cause long-term interest rates to rise by an amount that would offset almost all of the positive effects the tax cut

---

[2] No official Joint Committee on Taxation estimate is available. The $700 billion ten-year estimate assumes that revenues would decline by the same percentage as the reduction in the top corporate rate. There are factors that could lower the cost somewhat. For instance, although the vast majority of corporate profits (about 80 percent of them) are taxed at the top rate, some profits are taxed at lower rates. In addition, at lower tax rates, the corporate Alternative Minimum Tax — which is a parallel tax structure that would be unaffected by reductions in the regular corporate income tax rate — would affect more corporations and limit overall corporate tax revenue losses. On the other hand, the estimate may be conservative because it does not take into account the possible tax-avoidance tactics that are likely to arise when the top corporate rate is reduced below the top individual income tax rates. Of the nearly 5 million corporations in the country, more than half pay income taxes at the individual income tax rates. Known as "S corporations," these businesses enjoy the benefits of corporate status (such as limited liability, freely transferable ownership, and unlimited lifespan), but virtually all income is passed through to the shareholders and taxed as part of their individual returns; in 1998, these entities generated income of $182 billion. Currently, a significant share of S corporation income is taxed at individual income tax rates ranging from 27 percent to 38.6 percent. If the top corporate rate were lowered from 35 percent to 25 percent, there would be large incentives to convert individual income into corporate income to take advantage of these lower rates. Although this would increase corporate income tax revenues, it would lower individual income tax receipts by even more, resulting in a net revenue loss for the federal government. This trend would be exacerbated if high-income partnerships and nonfarm sole proprietorships, both of which are taxed at individual rates, shift to corporate status to take advantage of lower corporate rates.

otherwise would have on stock prices.[3] In short, with the bond market attracting more investor funds following a rise in long-term interest rates, the jump in stock prices predicted by the proposal's advocates is unlikely to materialize.

There are also practical reasons, given the current uncertainty in the stock market and the economy, why investors may not behave in the way that proponents of this proposal assume they will. For example, even if corporate earnings were to improve as a result of the tax cut, it is unclear whether investors would be willing to commit more money to stocks at this point in time. In the current environment, investors may simply be too risk averse to add more funds to the stock market, preferring instead the safety and stability of Treasury bonds, money market accounts, and certificate of deposits.

Similarly, even if investors did bid up the price of stocks, it is unclear whether they would respond to higher stock prices by spending more on goods and services. Evidence seems to suggest there is a "wealth effect," by which investors spend a few cents of each new dollar of additional wealth.[4] Yet one has to question, given the recent volatility in the market, whether investors would feel confident enough that stock prices would stay at these new higher levels to spend a significant portion of their increased wealth. Furthermore, according to both the Treasury Department and the Congressional Budget Office, the benefits of a corporate rate cut would flow to the owners of capital, who are typically high-income taxpayers — with more than half of the benefits flowing to the top 5 percent of earners and between 30 percent and 40 percent of the benefits going to the top 1 percent.[5] As a general rule, high-income taxpayers are more inclined to save and less inclined to spend an additional dollar than those with low and moderate

---

[3] In a forthcoming analysis, Gale, Orszag, and Sperling assume that the stock prices reflect the present value of corporate after-tax income. They find that an increase in long-term interest rates equal to 0.7 percentage points would offset the effects of a drop in the top corporate income tax rate from 35 percent to 25 percent. Relying on data from the Council on Economic Advisers, they also find that a reduction in public saving that amounted to 1.75 percent of the gross domestic product would cause long-term interest rates to rise by 2 percentage points. The proposed cut in the corporate tax rate would cost about 0.5 percent of GDP, resulting in approximately a 0.6 percentage point increase in long-term rates. Thus, the increase in interest rates would be sufficient to offset nearly all of the positive effects that lower corporate taxes otherwise would have on the stock market. See Council of Economic Advisers, *The Economic Report of the President*, 1994. In another study, Martin Feldstein found a similar relationship between changes in federal borrowing and long-term interest rates. See Martin Feldstein, "Budget Deficits, Tax Rules, and Real Interest Rates," NBER Working Paper W1970, July 1986.

[4] Alan Greenspan, "Opening Remarks at a Symposium Sponsored by the Federal Reserve Bank of Kansas City," August 31, 2001. The symposium was held in Jackson Hole, Wyoming.

[5] Both the Treasury Department and the Congressional Budget Office agree that the burden of corporate taxes is borne by the owners of capital — that is, corporate income taxes are not passed through to workers in the form of lower wages or passed through to consumers in the form of higher prices for goods and services. Julie-Anne Cronin, "U.S. Treasury Distributional Analysis Methodology," U.S. Treasury Department OTA Paper 85, September 1999. Congressional Budget Office, "The Incidence of the Corporate Income Tax," CBO Paper, 1996. Congressional Budget Office, "Estimates of Federal Tax Liabilities for Individuals and Families by Income Category and Family Type for 1995 and 1999," CBO Memorandum, May 1998.

incomes. Thus, a corporate rate cut would not be as effective at generating consumer spending as a tax cut that is more targeted on low- and moderate-income taxpayers, such as an income tax "rebate" for workers that paid payroll taxes (even if they owed no income taxes).

The Connection Between Federal Debt and Long-term Interest Rates

Most economists recognize the link between the national debt and long-term interest rates. If the federal debt increases relative to previous estimates, there will be upward pressure on long-term interest rates, because the federal government will be forced to borrow more. The increase in long-term interest rates will occur because, to accommodate additional borrowing, bond prices must fall and interest rates rise to attract more funds into the bond market. In other words, a higher rate of return on bonds is needed to increase the demand for bonds among investors. As interest rates increase, so too does the cost for corporations to invest in plant and equipment, because corporations issue bonds to finance many of these investments.

The opposite occurs when federal debt declines more than previously assumed. As Federal Reserve Chairman Alan Greenspan stated in testimony before the House Budget Committee in March 2001, "a declining level of federal debt is desirable because it holds down long-term real interest rates, thereby lowering the cost of capital and elevating private investment. The rapid capital deepening that has occurred in the U.S. economy in recent years is a testament to these benefits."

In testimony before the Senate Banking Committee on September 20, Chairman Greenspan raised concerns about the possible long-term implications of proposals to address the slowdown in the economy. He urged Congress not to abandon fiscal discipline as part of any effort to stimulate the economy, warning that long-term interest rates could rise if badly designed stimulus policies undermined the federal government's plans to pay down the national debt. Former Treasury Secretary Robert Rubin has issued similar warnings in recent days.

In this recent testimony, Chairman Greenspan noted that the long-term outlook for the economy remained positive. But, according to the *New York Times* report of the hearing (the official transcript is not yet available), Chairman Greenspan also said that one risk to the outlook would be if long-term interest rates shot up in response to concern among bond market investors that the government would not be able to pay down the national debt. According to the *New York Times* report, Greenspan warned that pumping money into the economy in an effort to spark a turnaround and to help specific industries could backfire by putting upward pressure on interest rates and could darken the economy's long-term prospects.* In short, proposals to institute large permanent reductions in the corporate tax rate run counter to the Fed Chairman's advice.

* Richard W. Stevenson, "Greenspan Hits Cautious Note on Relief Steps," The New York Times, September 21, 2001, C1.

Corporate Rate Cut An Ineffective Form of Stimulus

While a cut in the corporate income tax rate would be unlikely to provide the sharp increase in the stock market claimed by the proposal's supporters, it would nonetheless reduce the tax burden on companies that pay corporate tax. A corporate rate reduction is poorly designed, however, to encourage businesses to increase their investments in plant and equipment in the short term — the type of spending that is needed to stimulate a sagging economy. Rather, this tax cut would tend to benefit a particular type of business — primarily large, profitable corporations — and would not necessarily induce them to undertake new investments.

In 1998, more than 24 million business tax returns were filed. The vast majority of these enterprises were small businesses that do not pay corporate taxes. Rather, they pay taxes through the owner's individual tax return and thus will benefit from the tax reductions enacted earlier this year. In addition, among the businesses that are corporations, some were not profitable and owed no tax.[6] In total, fewer than 900,000 — or about 3.5 percent — of these businesses generated income in 1998 that was subject to the corporate tax. These represent some of the nation's largest and most profitable companies. It also should be noted that 1998 was a good year for business; fewer corporations are likely to be profitable and owe corporate income tax this year.

Supporters of the corporate rate cut maintain that tax savings would increase incentives for these companies to invest, as the tax cut would free up funds and raise the expected after-tax return on these new investments. Deputy Treasury Secretary Kenneth Dam, for instance, stated that a permanent reduction in the corporate income tax rate would "change corporate investment decisions overnight."[7] Clearly "overnight" is an overstatement. Investment decisions are rarely immediate; it takes time for businesses to plan new investments and execute those plans. Further, in the current uncertain and evolving economic environment, corporations are struggling to assess the applicability of their existing investment plans, making it less likely the proposed tax cut would somehow lead to a burst of new investment activity.

Moreover, it does not appear that lack of funds is a major reason for the recent decline in business investment. According to Federal Reserve data, financial assets held by corporations grew nearly 40 percent since 1997 and stood at $8.1 trillion at the end of June this year.[8] These data imply that many of these companies have the ability to fund new investments and are choosing not to undertake such investments based on other criteria, such as the high levels of

---

[6] Some profitable firms are also able to avoid paying corporate income taxes through the use of tax credits and other tax breaks. See Robert S. McIntyre and T.D. Coo Nguyen, "Corporate Income Taxes in the 1990s," Institute on Taxation and Economic Policy, October 2000.

[7] Richard W. Stevenson and Joseph Kahn, "Bush Tries to Steady Economy Jolted By Attack," The New York Times, September 23, 2001.

[8] Federal Reserve Statistical Release, Flow of Funds Accounts of the United States, Balance Sheet of Nonfarm Nonfinancial Corporate Business, Table L.102, September 18, 2001.

investment in plant and equipment they have made in previous years or projected low consumer demand for their products. Simply providing these companies with more cash through a tax cut would be a much less effective way to boost investment than, for instance, a tax incentive that is linked directly to undertaking new investment.

Furthermore, a reduction in the corporate income tax rate would not directly relate to new investment. It would provide benefits based on a firm's profitability. Thus, it would reduce taxes on returns associated with old capital and old investments made many years ago as much as new investments.

Some have argued that corporations benefitting from an income tax rate cut would pass these benefits along to consumers in the form of lower prices for goods and services. This argument is inconsistent with the claim also made by supporters of the corporate rate that it would increase stock prices. If a tax cut resulted in lower consumer prices rather than higher corporate profits, then corporate stocks would no longer be such an attractive investment and the predicted jump in stock market would not materialize. A corporate tax cut is unlikely to lower consumer prices, however, because (as noted earlier) most economists believe that the benefits of reductions in corporate taxes flow to the owners of capital and are not passed through to workers or consumers in the form of higher wages or lower prices.

Although advocates of a corporate income tax rate reduction have primarily focused on a permanent rate cut — as it is only with a permanent rate change that they can plausibly claim large increases in the stock market and business investment — there have been some calls for a temporary rate reduction. A temporary rate cut would be less costly than a permanent reduction and should have little adverse impact on long-term interest rates. But a temporary rate cut would retain other features of a permanent rate cut that make it an ineffective way to provide fiscal stimulus. For example, a temporary cut would be a blunt instrument for encouraging investment, providing benefits based on a company's profits rather than on its level of new investment.

In fact, a temporary rate cut could even discourage investment in the short run. Lower tax rates make tax deductions associated with the depreciation of capital investment less valuable, so corporations might decide to postpone these investments until corporate rates have returned to their higher levels (and the economic outlook has presumably become more clear). Given the weak arguments in favor of a temporary corporate income tax cut, one should be concerned that the real motivation for a temporary rate reduction is that it would be a first step on the path to a permanent rate cut.

Conclusion

If a decision is reached that fiscal stimulus is needed to revive the economy, the stimulus package should adhere to certain principles: funds should be infused into the economy quickly; the policy should be temporary; the policy should be well targeted to have a stimulative effect;

and it should be sound public policy. Proposals to reduce the corporate income tax rate to 25 percent or 30 percent on a permanent basis fail to meet these criteria.

Proponents of these proposals exaggerate their benefits by ignoring the countervailing negative effects of higher long-term interest rates, which almost certainly would result, given the large costs involved. Because of these higher interest rates, the rise in the stock market predicted by proponents of a corporate tax cut is unlikely to materialize. Similarly, the proposal is a poorly targeted means of boosting business investment in the near term or getting benefits to those businesses most likely to be struggling during the slowdown. With a ten-year price tag of $450 billion (for a rate cut to 30 percent) or $900 billion (for a rate cut to 25 percent), any stimulus that did result from a corporate rate cut would come at a very high price. Congress and the Administration should reject calls for enacting a permanent corporate income tax rate cut as a means of addressing the nation's short-term economic ills and should look instead to temporary proposals that directly encourage spending by consumers and businesses in the next few quarters.